FILED
AUG 29 2000
OFFICE OF THE CLERK

No. 00-8

IN THE

Supreme Court of the United States

ASA INVESTERINGS PARTNERSHIP,
AlliedSignal Inc.
(now Honeywell International Inc.),
Tax Matters Partner,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

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RULE 29.6 STATEMENT

Petitioner, ASA Investerings Partnership, was an investment partnership formed by AlliedSignal Inc. (AlliedSignal), AlliedSignal Investment Corporation (ASIC), Barber Corporation N.V. (Barber) and Dominguito Corporation N.V. (Dominguito). Of those four corporations, only AlliedSignal (now Honeywell International Inc.) has issued shares and/or debt securities to the public. Algemene Bank Nederland N.V. (now ABN Amro Bank N.V.), the indirect parent of Barber and Dominguito, has issued shares and/or debt securities to the public.

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Respondent frames the Question Presented as "whether petitioner was a valid partnership." Br. Opp. (I). He suggests that petitioner seeks nothing more than a review of factual determinations made by two lower courts. That is not correct. Respondent's own formulation inherently raises the fundamental legal issue here involved -- what is the proper legal standard to be applied in determining the validity of a partnership.

As the Petition for Certiorari establishes, there are three legal standards potentially applicable in determining whether AlliedSignal and ABN were partners in a valid partnership: (1) the *Moline* standard; (2) the Sec. 704(e)(1) standard; and (3) the *Culbertson* standard. The existence of these three competing standards has caused disagreement and conflict

among the lower courts as to which standard is to be applied in which circumstances, and even as to how a particular standard is to be applied. Given the confusion that currently exists and the considerable importance of the issue here presented, review of the instant case is fully warranted.

I. The *Moline* Standard.

The D.C. Circuit devoted a substantial portion of its opinion to an application of the *Moline* standard. It applied *Moline* in favor of respondent. Yet, respondent now seeks to disavow the application of *Moline* on the ground that it applies only to corporations and not to partnerships because partnerships are not taxable entities. Br. Opp. 15-16.

Both respondent's disavowal and the grounds offered are surprising. Partnerships are respected as separate entities for tax purposes even though they are not themselves taxable.[1] The Tax Court has had no difficulty holding that *Moline* applies to determine the validity of a partnership from its inception, even though it is not a taxable entity.[2] The court below certainly concluded that *Moline* applies to determine the validity of a partnership from inception.

Respondent's position is undoubtedly influenced by the fact that the D.C. Circuit's application of *Moline* to petitioner directly conflicts with the principles enunciated by this Court

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[1] *United States* v. *Basye*, 410 U.S. 441, 448 (1973).

[2] *Bertoli* v. *Commissioner*, 103 T.C. 501, 511-12 (1994) (*Moline* applied to test validity of partnership formed to hold certain property). See also *Campbell County State Bank, Inc.* v. *Commissioner*, 37 T.C. 430, 442 (1961), *rev'd on other grounds* 311 F.2d 374 (8th Cir. 1963)(with neither side challenging holding respecting separate existence of partnership); *Seminole Flavor Co.* v. *Commissioner*, 4 T.C. 1215, 1234-35 (1945), cited in *Campbell County*, *supra*.

in that case. Respondent freely admits that *Moline* applies a two-pronged "business purpose or business activity" test to determine whether a corporation should be respected for tax purposes: "*Moline Properties* stands for the straight-forward proposition that a corporation that serves a legitimate business purpose *or* that is engaged in legitimate business activity is ordinarily to be taxed on the income it earns." Br. Opp. 17 (emphasis added).

Accordingly, assuming *Moline* also applies to partnerships, the parties appear to agree that the decision below conflicts with *Moline*, as well as with decisions in numerous other circuits that have applied the two-pronged test articulated in *Moline*.[3]

Respondent hedges his bet on *Moline*. He contends that nothing in *Moline* validates "blatant tax-avoidance schemes." Br. Opp. 16. But that assertion ignores the significance of the Seventh Circuit's decision in *Northern Indiana Public Service*.[4] There, the Antilles conduit arrangement avoided U.S. withholding tax on interest paid to foreign lenders. It could easily be described as a "blatant tax-avoidance scheme." Yet, the arrangement was upheld by the Seventh Circuit under *Moline* because the Antilles subsidiary engaged in bona fide commercial activity.

Respondent seeks to distinguish *Northern Indiana* on the ground that, unlike the Antilles subsidiary there involved, petitioner "did *not* engage in legitimate business activities." Br. Opp. 18 (emphasis in original). However, even the court below acknowledged (App. 15a) that petitioner engaged in

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[3] See cases cited in Petition for Certiorari 17 n.16.

[4] *Northern Indiana Pub. Serv. Co.* v. *Commissioner*, 115 F.3d 506 (7th Cir. 1997), *aff'g* 105 T.C. 341 (1995).

extensive legitimate business activity, investing and reinvesting its capital in a wide range of securities throughout its 25-month existence, and earning and distributing $113 million in profits. In contrast, the Antilles subsidiary in *Northern Indiana* merely engaged in a pattern of borrowing funds from overseas, on-loaning the funds to its U.S. parent, and investing the small profit it earned for its role in the scheme.

The decision below is in direct conflict with *Northern Indiana* regarding *Moline*'s application to entities that may have been formed for a tax avoidance purpose, but that carried on legitimate business activity.

II. The Section 704(e)(1) Standard.

Section 704(e)(1) sets forth the second potentially applicable standard for determining whether petitioner was a valid partnership, because capital was a material income-producing factor in its operation. Petitioner believes that if *Moline* is not the proper standard to apply here, Sec. 704(e)(1) is.

Respondent claims that Sec. 704(e)(1) applies only to determine whether a particular person has become a partner in an existing partnership, not whether an arrangement that purports to be a partnership is to be recognized as valid. Br. Opp. 19. But both *Culbertson* and *Tower*, on which respondent relies, involved the validity of newly-formed partnerships, and Sec. 704(e)(1) was enacted to eliminate the confusion spawned by those cases.[5] Does it not follow that Sec. 704(e)(1) must apply to newly-formed partnerships as well as to partnerships already in existence?

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[5] H.R. Rep. No. 586, 82d Cong., 1st Sess. 32-34(1951), *reprinted in* 1951 U.S.C.C.A.N. 1781, 1813-15; S. Rep. No. 781, 82d Cong., 1st Sess. 38-41 (1951), *reprinted in* 1951 U.S.C.C.A.N. 1969, 2008-10.

That was certainly the conclusion reached by the Seventh Circuit in *Evans* v. *Commissioner*.[6] There, Sec. 704(e)(1) was applied to establish the existence of a newly-created partnership following the technical termination of an existing partnership.[7] By applying *Culbertson* in lieu of Sec. 704(e)(1) here, the court below has put itself in direct conflict with *Evans*.[8]

Respondent claims there can be no conflict with *Evans* because the D.C. Circuit "had no occasion" to consider petitioner's "newly minted" Sec. 704(e)(1) argument that was "belatedly" injected into the case. Br. Opp. 18-19. Respondent's position is factually incorrect and therefore without foundation. Petitioner's Sec. 704(e)(1) argument is not "newly minted" and was not "belatedly" offered.[9] The court

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[6] 447 F.2d 547 (7th Cir. 1971).

[7] Sec. 704(e)(1) has also been applied by the Tax Court in partnership formation cases. See, *e.g.*, *Ketter* v. *Commissioner*, 70 T.C. 637 (1978) (also cases there cited), *aff'd without opinion*, 605 F.2d 1209 (8th Cir. 1979); *Carriage Square, Inc.* v. *Commissioner*, 69 T.C. 119 (1977). Here, the Tax Court could not have applied Sec. 704(e)(1) because of its holding that ABN had "loaned" its funds to AlliedSignal.

[8] Compare *Bayou Verret Land Co.* v. *Commissioner*, 450 F.2d 850 (5th Cir. 1971), cited by respondent below but not cited in his Brief in Opposition.

[9] Petitioner raised Sec. 704(e)(1) and the *Evans* case in its opening brief on appeal. D.C. Cir. Pet. Br. 30, 32-33. Respondent's responsive brief addressed the merits of the argument, in much the same language that now appears in his Brief in Opposition. Compare D.C. Cir. Res. Br. 51 with Br. Opp. 19-20. Petitioner answered respondent's arguments in its reply brief below, filed August 12, 1999. D.C. Cir. Pet. Rep. Br. 7-9. Petitioner's counsel also referred specifically to Sec. 704(e) in the oral argument held on October 19, 1999. Transcript 4.

below had ample opportunity to consider petitioner's Sec. 704(e)(1) argument. It simply chose not to do so.

III. The *Culbertson* Standard.

Respondent contends that *Culbertson* (along with *Tower*) sets forth the only proper standard for determining whether AlliedSignal and ABN were partners in a valid partnership. Respondent's position is not tenable. Congress chose to enact Sec. 704(e)(1) to bring certainty to an area where the lower courts had become confused following the decisions in *Culbertson* and *Tower*.[10] Congress did not intend to have *Culbertson* remain the governing standard for determining the validity of partnerships where capital was a material income-producing factor.

If *Culbertson* does govern the instant case, the court below failed to apply the *Culbertson* standard properly by refusing to consider whether ABN's cash outlay constituted a capital contribution to petitioner rather than a loan to AlliedSignal. App. 22a. Respondent glosses over this failure by claiming that this Court "stressed" in *Culbertson* that "even a legitimate capital contribution does not necessarily render an arrangement a partnership." Br. Opp. 13 n.8.

Contrary to respondent's view, what this Court "stressed" in *Culbertson* was the importance of determining, from among the facts and circumstances considered, whether the putative partner had contributed services or capital to the venture. *See* 337 U.S. at 742, 744, 748. That is particularly clear from this Court's statement remanding *Culbertson* to the Tax Court to determine which, if any, of the taxpayer's four sons were partners with him in the operation of his ranch.

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[10] See *supra* note 5.

> As to which of them, in other words, was there a bona fide intent that they be partners in the conduct of the cattle business, either because of services to be performed during those years, or because of contributions of capital of which they were the true owners, as we have defined that term in the *Clifford*, *Horst*, and *Tower* cases?

337 U.S. at 748 (emphasis added). In short, a contribution of services or capital to the venture was seen by this Court as strong, if not conclusive, evidence of an intent to be a partner in the venture.

Here, the Tax Court's "loan" determination eliminated the capital contribution issue and thus was a very important factor in its *Culbertson* analysis. Respondent conceded below that ABN's cash outlay did not appear to be a "loan." Yet, the D.C. Circuit refused to address the capital contribution v. loan issue. That refusal cannot be reconciled with *Culbertson*'s requirements.

* * *

Either *Moline* (particularly as applied in *Northern Indiana*), or *Evans* (applying Sec. 704(e)(1)), or *Culbertson* sets forth the proper standard for determining whether petitioner was a valid partnership. It should be apparent from the foregoing that the decision below conflicts, in whole or in part, with each of those decisions. In addition, the decision below is "incompatible with basic principles of income taxation as developed in [this Court's] prior cases." *Basye*, *supra*, at 442. For those reasons, review should be granted.

If the decision below is left unreviewed, its erroneous interpretation of *Moline*, its failure to consider the application of Sec. 704(e)(1), and its misapplication of *Culbertson* are

certain to cast a large shadow of doubt over the manner in which lower courts are to determine whether participants in an unincorporated venture are in fact partners in a valid partnership. Guidance from this Court is sorely needed in order to ensure that, in future cases, the lower courts will adopt a proper and uniform approach to resolving the fundamental issue here presented.

CONCLUSION

For all of the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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